

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of Mayor Dick Murphy on May 2, 2006

DATED: May 17, 2006

On Tuesday, May 2, 2006, Benito Romano and Sharon Blaskey, in Willkie Farr & Gallagher LLP's ("Willkie") capacity as counsel to the Audit Committee, interviewed former Mayor Dick Murphy. Mayor Murphy was represented by counsel, Pamela Naughton and Rebecca Shults of Sheppard, Mullin, Richter & Hampton LLP. Also in attendance were Troy Dahlberg of the Audit Committee, William Haegele of KPMG, and Brian Faerstein of Willkie. The interview took place in a conference room in the offices of Sheppard, Mullin, Richter & Hampton LLP in Del Mar Heights, California and lasted approximately six hours.

The following memorandum reflects my thoughts, impressions, and opinions regarding our meeting with Mayor Dick Murphy, and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

Warnings

Mr. Romano began the interview by explaining the circumstances and purpose of the City of San Diego's (the "City") creation of the Audit Committee, noting that information obtained during the course of the interview would be used, if relevant, in the Audit Committee's eventual report. Mr. Romano explained that Willkie does not represent Mayor Murphy and, thus, statements made during the interview are not covered by the attorney-client privilege. Nonetheless, we would be treating the matters discussed during the interview as confidential, covered by the work-product privilege, but any such privilege would likely be lost with the release of the Audit Committee's report. Mr. Romano asked that Mayor Murphy keep the interview confidential. Mr. Romano further explained that, if requested, we would provide information from the interview to the SEC, the U.S. Attorney's Office or the City's outside auditor, KPMG, so it is important that Mayor Murphy be accurate and truthful. Mr. Romano emphasized that Mayor Murphy should seek clarification of any question at any time.

Background

Prior to being elected Mayor in November 2000, Mayor Murphy had previously served on the San Diego City Council, representing District 7 between 1980 and 1985. Mayor Murphy had worked as an attorney in private practice at Luce, Forward, Hamilton & Scripps LLP when Governor Pete Wilson appointed him in 1980 to fill the seat for District 7 which had become vacant. Mayor Murphy was re-elected and served one full term on Council between

1981 and 1985. Mayor Murphy noted that he was a vested member of the Retirement System during his brief service on Council. Mayor Murphy was appointed to be a California Municipal Court Judge in 1985 and, subsequently, to be a Superior Court Judge in 1989. Mayor Murphy decided to run for elected office again in 1999, when he resolved that he could make a bigger contribution as Mayor than he could as a judge. He understood that he could take an unpaid leave of absence as a judge if he were elected. Asked how he stayed involved in politics while he was a judge, Mayor Murphy explained that he read the newspaper carefully and remained close with his friend Judy McCarty, who had succeeded him as the District 7 representative to City Council in 1985.

Mr. Romano asked Mayor Murphy whether the City's financial condition factored into his campaign for Mayor in 2000. Mayor Murphy explained that the City's general fiscal health was not much of an issue during the campaign. He included a discussion of this issue in his January 2001 "State of the City" Address -- in particular, his suggestion to create the Blue Ribbon Committee ("BRC") to examine the City's financial health -- because he wanted to set a benchmark of where the City was and bring a fresh outlook to the Mayor's Office. Mayor Murphy explained that William Jones, head of his transition team, had suggested the idea of creating the BRC to determine the most significant problem the City faced because Mayor Murphy was not an insider. Asked whether there was a sense that there was not accurate information available within the City bureaucracy, Mayor Murphy responded that he did not believe so at the time.

Mayor Murphy explained that he established six advisory boards in his first few months in office. These advisory boards were not financially-related and pertained to the following issues: Environment; Veterans; African-American affairs; Asian-Pacific affairs; Latino affairs; and Lesbian, Gay, Bisexual and Transgender affairs. Mayor Murphy explained that these advisory boards continued to function throughout his first term, but not during his second term as his administration lost focus of many of these issues because of a number of post-election lawsuits and the City's financial problems.

Mr. Romano inquired about Mayor Murphy's staff when he first took office. Mayor Murphy explained that he had around twenty-five staff members, some of whom he had kept from Mayor Susan Golding's staff, including her Director of Community Relations. He mostly hired new staff, both from his campaign and from other City offices. John Kern, his Chief of Staff, had served as Mayor Murphy's Chief of Staff when he served on Council in the early 1980's and Judy McCarty's Chief of Staff when she succeeded him. Kern had also worked as a political consultant in Mayor Golding's administration and ran Mayor Murphy's 2000 campaign. Paula Avila served as the Mayor's Deputy Chief of Staff, working under Kern.

Tom Story, who had previously served as Deputy Director of Planning for the City, became one of Mayor Murphy's Senior Policy Advisors, handling issues such as energy, sewer spills and land use. Dennis Gibson, who had previously worked in the Financial Management office, was the Mayor's other Senior Policy Advisor, advising on issues such as the ballpark project and police and fire department affairs. Mayor Murphy noted that Story and Gibson managed the implementation of most of the Mayor's "Ten Objectives" laid out at the beginning of the Mayor's first term. Rachel Shira, who had worked on the Mayor's 2000 campaign, was his Director of Scheduling. Colin Rudy served as the Mayor's Press Secretary

and Elena Salsis as his Director of Protocol. Bill Baber was the Mayor's Docketing Clerk, deciding when issues were heard at City Council and Rules Committee meetings. Mayor Murphy explained that Baber operated on his own in this capacity around 90% of the time. The City Manager's Office would send items to Baber to schedule and Mayor Murphy would discuss timing issues with him, with the objective of avoiding the scheduling of two controversial issues for the same meeting.

Ethics Commission

Referring to the "Ten Objectives" that Mayor Murphy laid out in his January 2001 "State of the City" Address, Mr. Romano asked Mayor Murphy why one of his goals was to establish an Ethics Commission. Mayor Murphy explained that, during his 2000 campaign, the Valerie Stallings bribery scandal was a big story in the news (Councilmember Stallings accepted gifts from Padres' owner John Moores, allegedly in exchange for her support of the project to build a new ballpark for the team). Mayor Murphy noted that he learned about California Government Code section 1090 -- a provision prohibiting conflicts of interest among elected officials -- for the first time in connection with this scandal. A reporter from the San Diego Union-Tribune issued a challenge to both Mayor Murphy and his primary opponent, Ron Roberts, to explain how they would effectively deal with ethics problems in government if they were elected. Subsequently, this question became a major issue in the campaign. Mayor Murphy explained that a friend told him about a proposition to form an ethics committee in San Diego in the 1990s that was voted down. Mayor Murphy looked into this prior effort and decided to adopt it as one of his campaign platforms. Mayor Murphy noted that he specifically adopted the tenets of the committee that had been proposed earlier.

Mr. Romano asked Mayor Murphy whether his conception of the Ethics Commission was that it would be targeted at Stallings-like issues or would be broader in scope. Mayor Murphy explained that his objective was that it would cover a broad range of issues pertaining to public officials, including: campaign-related concerns (e.g., contributions); elections; Statements of Economic Interest (filed by officials); and "revolving door" considerations (i.e., former City officials using government contacts in the private sector). Once Mayor Murphy appointed members to the Commission, he delegated to them the responsibility to examine other such ethics-related committees in other cities and states. The Mayor and Council ultimately approved the Commission's proposal in terms of both structure and substance. Mayor Murphy explained that, once implemented, the Commission performed an advisory role, in that officials could write a letter to the Commission and receive individual guidance regarding a proposed course of action and would be protected by following the advice.

Mr. Romano asked Mayor Murphy whether the Ethics Commission ever dealt with conflicts of interest of City employees, in particular those who donned two "hats" in different positions. Mayor Murphy responded that the Commission did not deal with those types of issues. Mr. Dahlberg asked Mayor Murphy whether he would advise Council members to speak with the Commission and, if so, how the Commission's advice would have compared to that of the City Attorney's Office. Mayor Murphy explained that, at the time, he believed advice from the City Attorney's Office was reliable. However, the City Attorney's Office did not deal with some of the issues for which the Ethics Commission was established, in particular campaign ethics issues, so the two bodies were rather complementary. Mayor Murphy pointed out that his

office worked directly with Casey Gwinn (City Attorney) in drafting the framework of the Commission, so it was a collaborative effort with the City Attorney's Office.

Ballpark Project

Mr. Romano asked Mayor Murphy about the status of the ballpark project when he took office in December 2000. Mayor Murphy explained that it was a "hole in the ground" when he arrived and was not moving forward, mostly because of a flood of lawsuits surrounding the project (almost half of which were brought by Bruce Henderson). There had previously been a three-party arrangement for financing the project but the funds had been used up. Mayor Murphy noted that no one would underwrite bonds for the ballpark with seventeen lawsuits pending. Mr. Romano asked whether the City had good defenses to these litigations. Mayor Murphy stated that the real problem was that they existed at all, noting several of the specific issues being litigated: conflicts of interest related to Councilmember Stallings; environmental regulations; and public financing laws.

Mayor Murphy briefly recounted the background of the Stallings scandal and lawsuit. Moores had paid for Councilmember Stallings to visit her sick mother, and Councilmember Stallings ultimately approved the ballpark project. State law prescribes that if an elected official receives a gift of over \$300 from a party involved in an event that the official *will be voting on*, the official must abstain from the vote. If the official receives a gift of less than \$300 but more than \$50, he must report the gift by way of a financial disclosure form. Mayor Murphy explained that any elected official, quasi-judicial official, or high-level City employee -- or, generally, any official making discretionary decisions -- must file financial disclosure forms, which are public documents. Councilmember Stallings was charged with misdemeanors for failing to report gifts and recuse herself from the Council vote and pleaded guilty in January 2001. She resigned and the City Council had to revote on every aspect of the Ballpark project in March 2000. Several citizens filed a lawsuit under Government Code section 1090 based on Stallings's violations.

Mr. Romano asked Mayor Murphy about how the ballpark project was resurrected. Mayor Murphy explained that the original conception of the financing plan was tied into a Hilton Hotel being financed and built near the downtown ballpark. Since the Hilton project was also tied up in lawsuits, the City had to come up with a new idea for a financing plan. The new financing plan included money from tobacco funds and two new hotels, one of which was to be built next to the ballpark (these hotels were to be primarily funded by revenue from an occupancy tax). The City substituted the projected revenue from these sources into the hole in the budget where the Hilton funding would have been. The City eventually filed a successful validation action to satisfy the underwriters of the bonds and the public offering was underway.

Mr. Romano inquired whether Gibson was the Mayor's chief consultant with regard to the ballpark project or whether many other staff members were involved. Mayor Murphy explained that since the project was such a big issue during his first year, the Mayor established an informal task force between the Mayor's Office and the City Manager's Office. Baber represented the Mayor's Office in most of these informal communications, as he regularly worked with the City Manager's Office in the scheduling of docket items.

Blue Ribbon Committee

Mr. Romano asked Mayor Murphy about how long it took to appoint the Blue Ribbon Committee ("BRC") after he announced his intention to create it in January 2001. Mayor Murphy explained that this process took longer than he had expected, noting that he "bit off a bit more than he could chew" during his first few months in office. The six advisory boards he had created took a lot of time to appoint and manage. Also, he had created four task forces that dealt with a variety of issues: Clean Water (collaborating with Councilmember Scott Peters), Freeway Congestion (collaborating with Councilmember Brian Maienschein), Smart-Growth Implementation, and the River Alliance. Avila was in charge of staffing the members of these advisory boards and task forces, so there was some delay in appointing some of the committees, including the BRC. Mayor Murphy believed he appointed the BRC in May 2001.

Mr. Romano showed Mayor Murphy an undated work plan for the BRC's anticipated schedule, projecting the BRC Report would be presented to the Mayor on September 7, 2001 (Exhibit 1). Mr. Romano asked Mayor Murphy whether, once the BRC was appointed and began working, the BRC provided the Mayor's Office with interim reports of their progress. Mayor Murphy explained that, "they were basically set off to do what they thought was appropriate and I didn't pay any attention to them." Mayor Murphy noted that Gibson would have been his liaison to the BRC. Mr. Romano asked whether Mayor Murphy recalled Gibson mentioning anything about the BRC's findings. Mayor Murphy recalled that in January 2002 Gibson informed him that the BRC had completed its Report and wanted to present its findings to the Mayor. Mayor Murphy could not recall receiving any updates before this time, noting that he was very busy with the creation of the Ethics Commission and the ballpark project during 2001. Asked whether he recalled a sense of internal tension within (or surrounding) the BRC in terms of the tone of the Report, Mayor Murphy stated that he could not remember hearing anything like that. Mr. Romano asked Mayor Murphy whether he had a schedule in his mind as to the BRC's work and connected the project with any other matters going on at the time. Mayor Murphy could not recall such a time frame, noting that he just expected the BRC would report to him and Council when it had an answer.

Mayor Murphy explained that the BRC met with him around two weeks before its presentation to the Rules Committee on February 27, 2002, providing him with a preview of its findings. Mayor Murphy could not recall who attended this meeting with him, but believed that Kern and Gibson were likely there, and possibly Baber and Rudy. Mayor Murphy believed that Joe Craver, the head of the BRC, made this preview presentation, but he could not recall whether Richard Vortmann (BRC member) was also in attendance. Mr. Romano asked Mayor Murphy whether he had any concerns at that point that the BRC's findings would have a negative impact on other matters going on in the City, particularly the ballpark project. Mayor Murphy believed that he felt the opposite way, namely hoping that the BRC would come back with very negative findings so he could peg the City's problems on the Golding Administration and move forward in solving them. He believed that it would have been easy to pass the buck, so he was not concerned about bad news from the BRC. Asked whether the ballpark bond offering had been issued at that point, Mayor Murphy recalled that the bonds were sold in mid-February 2002. Mr. Romano asked Mayor Murphy whether he was at all concerned that negative findings could be a major news item or lead to more lawsuits. Mayor Murphy stated that these thoughts did not enter his mind, noting that the City ended up doing a de facto private placement of the ballpark

bonds through Merrill Lynch with a very high interest rate. The major risks surrounding this offering, he explained, were the necessity of engaging an insurance company to cover the offering and the uncertainty of several litigations still pending.

Mr. Romano showed Mayor Murphy the transcript from the February 27, 2002 Rules Committee meeting at which the BRC made its presentation (Exhibit 2). Mr. Romano inquired about Mayor Murphy's general recollection of this meeting. Mayor Murphy recalled being present and that two of the issues presented related to the pension fund, but he did not believe at that point that the pension fund was the big issue. He recalled that he thought deferred maintenance seemed the most important aspect of the presentation, given the build-up of necessary repairs that the City had been putting off for years in order to balance the budget. With regard to the pension issue, Mayor Murphy recalled a vague reference that the City was not paying as much into the Retirement System as it should have been. Also, he recalled learning of the contingent healthcare benefit that was growing every year and to which the City did not pay close attention. Mayor Murphy noted that he believed there was more emphasis on the latter issue than the former. However, he believed both these issues were just part of the overall Report and were not isolated in any particular way.

Mr. Romano directed Mayor Murphy's attention to page 35 of the transcript and Ed Ryan's (City Auditor & Comptroller) comment that the pension fund was "intentionally back-loaded." Asked whether he understood what this comment meant at the time and whether it was cause for alarm, Mayor Murphy responded that he did not understand the significance of this notion, at least "not at the Rules Committee meeting of February 2002." Mr. Romano directed Mayor Murphy's attention to page 36 of the transcript, in particular to Mayor Murphy's ("Chairman" in the transcript) comment that, "[w]e have put our head in the sand" as to the pension fund issue. Mayor Murphy explained that he likely meant that the City had passed off the retirement issue for a long time and had not addressed how the pension system was being funded. Mr. Romano asked Mayor Murphy whether \$6-8 million -- which was how much Ryan stated the Retirement System was being under-funded per year at the time -- was a significant number to him at that meeting. Mayor Murphy could not specifically recall hearing those numbers at the meeting, though he could remember someone asking Ryan how under-funded the system was. Mr. Romano directed Mayor Murphy's attention to page 38 of the transcript and Vortmann's statement that the "grave concern" expressed by some members of the BRC was that even coming off of an economic boom, the pension fund still was in a deficit. Mayor Murphy could not recall Vortmann making this statement, though he recalled that he was at the meeting. Mayor Murphy later stated that he could not recall learning of Vortmann's concerns about the possible "spin" on the BRC Report until he was interviewed by Vinson & Elkins ("V&E") in July 2004. Though Mayor Murphy recalled he likely spoke with Vortmann socially after public meetings, he could not recall specifically discussing with Vortmann his concerns about the BRC Report.

Mr. Romano later showed Mayor Murphy a March 4, 2002 letter from Vortmann to Mayor Murphy regarding Vortmann's concerns about the "tone" of and "spin" put on the BRC Report (Exhibit 3). Asked whether he recalled seeing this letter, Mayor Murphy explained that he did not believe he saw it in 2002, but rather in 2004 or 2005 during an interview. Mr. Romano inquired about how this letter could not have received special attention from his staff. Mayor Murphy speculated that his staff would have seen it, but explained why he may not have

seen it "in normal course" as Mayor. He emphasized that he worked eighty-hour weeks and spent half the time preparing for public meetings -- such as those for City Council, Rules Committee, Transaction Board, Transportation Board, and the ten other advisory boards and task forces on which he participated. After constituent dinners and speeches, he speculated that he had around twenty hours left to do substantive work. Accordingly, he made a decision that letters and correspondence like the one from Vortmann should be "intercepted by the appropriate person" and delegated to the staff member best equipped to respond. Mayor Murphy noted that he would almost never see letters like Vortmann's unless they were personal in nature. Mayor Murphy believed Gibson would have received this letter and likely have given it to Kern but it was not atypical for Kern not to have shown it to him.

Mr. Romano sought clarification as to whether a complaint from a member of an important committee such as the BRC about the substance of the committee's report would have been perceived by the Mayor's staff as an everyday occurrence. Mayor Murphy explained that it was not uncommon for a member on a board or committee to be unhappy with the work of that group, analogizing this situation to his recollection of a prior time when someone on the Arts and Culture Commission had complained about the commission's work.

Mr. Romano asked Mayor Murphy whether he had a sense that his Council colleagues understood the complexities of the information underlying the Retirement System. Mayor Murphy responded, "I don't think anyone understood the pension system and how it was funded." Asked why there were not a lot of questions among those in attendance at the Rules Committee meeting, Mayor Murphy explained that, with regard to his own understanding of the issue, he believed that the San Diego City Employees' Retirement System ("SDCERS") Board would have handled concerns about the pension fund. Mayor Murphy pointed back to his meeting with the BRC before the February 27, 2002 Rules Committee meeting, noting that that was the first time he had heard the word "pension" and, believing it was a highly complicated issue, assumed it was being handled by the SDCERS Board. Mayor Murphy noted that since he was having a hard time understanding the issue, he would assume that the other Council members likely also had a hard time getting a grasp of the subject.

Mr. Romano showed Mayor Murphy the transcript from the March 20, 2002 Rules Committee meeting at which City Manager Michael Uberuaga made a preliminary response to the BRC Report (Exhibit 4). Mr. Romano directed Mayor Murphy's attention to page 17 and 18 of the transcript, in particular to the paragraph beginning with Mayor Murphy's statement, "I don't think it is like a crisis situation, but it is a serious situation and we need to address it." Mr. Romano asked Mayor Murphy what he meant by "workshop" in the context of the paragraph. Mayor Murphy believed that his intent was to try to examine the issue in-depth by taking the information they had already learned from the BRC, delving into the details of the issue and soliciting recommendations based on the new information obtained.

Mr. Romano directed Mayor Murphy's attention to page 21 of the transcript and his statement, "Nevertheless, I think we need time to address it. It is a complicated issue and we need to look to the Retirement Board to tell us first what they think." Mr. Romano asked Mayor Murphy why he believed that a City funding-related problem should have been delegated to the SDCERS Board for review and advice. Mayor Murphy explained that this decision "probably reflected his lack of understanding about how the whole thing worked" and his "fuzzy thinking

of this whole issue.” He believed that he did not understand the function of the SDCERS Board at the time, as both the issue and the SDCERS Board were new to him early in his term. He explained that he saw the SDCERS Board as a department of the City that ran the Retirement System. Asked whether he was aware that the BRC had access to information from the SDCERS Board during its investigation, Mayor Murphy stated that he could not recall knowing that at the time. Mr. Romano asked Mayor Murphy whether he had any discussions with the City Manager’s Office about whether referring the issue to the SDCERS Board was the appropriate next step, noting that that would have been the City Manager’s Office’s decision. Mayor Murphy recalled that the City Manager’s Office did in fact refer the issue to the SDCERS Board.

Mr. Romano showed Mayor Murphy a March 18, 2002 Manager’s Report to the Rules Committee regarding the City Manager’s preliminary response and recommendations to the BRC Report (Exhibit 5). Mayor Murphy recognized the document and noted that this typically is how this type of process would have worked, namely the City Manager would respond to an initial report made to Council or the Rules Committee with a preliminary set of recommendations. Mr. Romano directed Mayor Murphy’s attention to page 2 of the Manager’s Report and the City Manager’s plan of action in response to BRC recommendation numbers two and three. In particular, Mr. Romano noted that the City Manager referred the issue to the “City Retirement Officer” for a thorough study and planned for an ultimate report by both the City Retirement Officer and the City Manager to the Mayor and City Council. Mayor Murphy noted that the City Manager’s recommendation was rather vague and that he did not refer the matter directly to the SDCERS Board, as Mayor Murphy previously stated. Mr. Romano asked Mayor Murphy to clarify what his intention was in sending the matter to the SDCERS Board. Mayor Murphy explained that he could not specifically recall, but believed he was just following the City Manager’s recommendation “as vague as it may be.” He noted that he thought the language in the passage at issue denoted that the City Manager and SDCERS would work together toward a proposal.

SDCERS Response to the BRC Report

Mr. Romano asked Mayor Murphy how urgent he believed the above response needed to be. Mayor Murphy believed that the issue needed to be dealt with sooner rather than later, recalling that he sent out a memo requesting a report on the pension fund matter by June 30, 2002. Mayor Murphy recalled that this memo stated the pension issue as the top priority. Mr. Romano showed Mayor Murphy an April 4, 2002 memorandum from Mayor Murphy to City Council regarding the Rules Committee’s recommendations in response to the BRC Report and the City Manager’s preliminary response (Exhibit 6). After examining this memorandum, Mayor Murphy noted that the pension issue may not have necessarily been slated as the top priority. He explained that he tended to put deadlines on every issue so they “wouldn’t disappear.”

Mr. Romano asked Mayor Murphy about who on his staff would have been responsible for tracking deadlines. Mayor Murphy did not believe a specific staff member had that duty, but he believed that Baber would likely have been the person generally responsible, as he was in charge of docketing the Rules Committee and City Council meetings. Mr. Romano asked Mayor Murphy whether he recalled Baber telling him that there was no action coming from the SDCERS Board on the pension funding issue. Mayor Murphy could not recall hearing

this from Baber at the time, but he recalled that the SDCERS Board requested an extension for its report.

Asked whether he recalled anyone generally remarking that it was taking the SDCERS Board a long time to respond, Mayor Murphy emphasized that he did not and explained that it was important to "put this in context." He explained that he had set ten goals at the beginning of his term, with the Ethics Commission and the ballpark project being top priorities. Once those goals were largely completed by the beginning of 2002, his office turned to many of the other goals on the original list, in particular that of improving the City library system. He recalled that they set July 2002 as the goal for completing that project. Asked why the library project was controversial, Mayor Murphy explained that he and Councilmember Jim Madaffer sought to rebuild the City's main library in addition to building new libraries in other parts of the City. There was not a consensus as to this approach, so they had to work hard for a compromise to this issue and satisfy the interests of a number of other Council members. In terms of the "context" of this time period, Mayor Murphy also noted that there was "all that ugly Meet-and-Confer stuff." He explained that, overall, the BRC Report was not a high enough priority at the time (presumably, the summer and fall of 2002) "to be harassing people over."

Mr. Romano showed Mayor Murphy a February 6, 2003 SDCERS PowerPoint presentation entitled, "Report on the Mayor's Blue Ribbon Committee on City Finances," apparently prepared for the SDCERS Board's February 12, 2003 presentation to the Rules Committee (Exhibit 7). Mr. Romano directed Mayor Murphy's attention to page 9, which stated the SDCERS funding ratio as of June 30, 2002 to be at 77.3%. Asked what happened after this presentation, Mayor Murphy believed that the City Manager was asked to respond within sixty days, a response which would have constituted his final recommendations. Explaining that the issue of funding sources was missing from this presentation, Mr. Romano asked Mayor Murphy whether he believed the City Manager understood that one of the elements of his response should have addressed that open issue. Mayor Murphy believed that the City Manager understood that he was supposed to take the recommendations made by the SDCERS Board and craft a response. Apparently speaking for Council, Mayor Murphy recalled that, "we certainly intended him to come back in 60 days."

At this point, Mayor Murphy recalled that, sometime before the February 12, 2003 Rules Committee meeting, Tim Pestotnik (from the City's outside litigation counsel, Luce, Forward, Hamilton & Scripps LLP) and several attorneys from the City Attorney's Office "marched" into his office to discuss the City's handling of the *Gleason* litigation filed in January 2003. Mayor Murphy believed that Les Girard (Deputy City Attorney) was present at this meeting, as were the City Manager and several members of the Mayor's staff. Mayor Murphy recalled that the attorneys told him and his staff that Council should not hold a public hearing about the pension fund issue, as such would hurt the City's litigation strategy in its defense of *Gleason*. Mayor Murphy recalled that his staff -- and, in particular, Kern -- disagreed with this approach, as they believed that the City needed to act on the pension problem. Mayor Murphy believed that the City Manager took a neutral position. The Mayor and his staff ultimately deferred to Pestotnik and the City Attorney's Office and no public hearing was held.

Mr. Romano asked whether this decision not to address the pension problem at an Open-Session Council meeting undercut the City's work to prepare a response to the SDCERS

Board's February 12, 2003 Rules Committee presentation. Mayor Murphy stated that it did not affect the City's response, as the City Manager continued to work on a response during the spring and summer of 2003. However, Mayor Murphy explained that, during that time period, City officials from various offices could not agree on how to approach the pension funding issue. Mayor Murphy recalled three different "camps." First, some officials thought that the problem derived from stock market losses and would be solved when market conditions improved. In particular, these officials believed that with the City's increased contributions through the MP-2 modified rates, there would be increased assets in the pension fund which would yield larger returns when the market recovered. Mayor Murphy believed that these officials sought to maintain the funding ratio at around 80% and would have believed that the City "wouldn't have a crisis" at this funding level. Second, another camp believed that the City needed to issue Pension Obligation Bonds ("POB") to begin the process of closing the funding gap. Third, a number of other officials believed that the Retirement System was in trouble and the City needed to find a way to raise its contributions to the pension fund. Asked where specific officials stood on this continuum, Mayor Murphy recalled that Ryan was opposed to issuing POBs whereas Pat Frazier (Deputy City Manager) supported the idea, noting that Uberuaga was a fence-sitter. Mayor Murphy explained that, overall, there were many unproductive meetings and a lot of in-fighting among City officials to the point where he was "not sure if he was getting the full story."

Mr. Romano asked Mayor Murphy whether he could have just directed these officials to come up with a recommended solution. Mayor Murphy explained that it would have violated the City Charter to do so, as the City Manager was the City's "CEO" and the Mayor could not direct anyone to do anything without a majority vote of Council. Mayor Murphy noted several other possible courses of action he entertained at the time, including having the City join the State Public Employees' Retirement System ("PERS") or switch from a defined benefit plan to a defined contribution plan. However, he ultimately decided to cut through all of the disagreement within City government by creating a committee of outsiders to study the problem and come up with an objective set of recommendations.

Pension Reform Committee

Mayor Murphy characterized his decision to create the Pension Reform Committee ("PRC") in mid-2003 as "a mistake he made" in terms of dealing with the pension fund issue. He believed this was a bad idea because it took too long, noting that, "if I had to do it all over again, I would have never created the Pension Reform Committee." He stated that "others" probably did not agree with his creation of the PRC. However, Mayor Murphy still believed that the ultimate recommendations of the PRC were mostly on point and were needed, noting that some of the PRC's findings were new to the Mayor and Council (e.g., thirty-year amortization period was too long). Mayor Murphy recalled that the PRC found that the SDCERS investment returns over time were actually rather steady, which conflicted with the information he had previously received regarding the pension fund deficit deriving from investment losses. He also believed that this was the first time that he came to understand that the City had squandered the surplus earnings of the pension fund and that increased benefits were further squeezing the system.

Mayor Murphy recalled that the City Council adopted two-thirds of the PRC's recommendations, which he believed were reliable because of the number of accountants on the

PRC. Mr. Romano asked Mayor Murphy whether he ever spoke with Vortmann about his appointment to the PRC as related to his earlier service on the BRC. Mayor Murphy explained that Vortmann was appointed to the BRC because he was a prominent businessman; he was appointed to the PRC because of the interest he had taken in retirement issues and his position on the SDCERS Board. Mayor Murphy believed that Vortmann was objective and "got beat up unfairly." Summing up his sentiment about the PRC, Mayor Murphy believed that the committee was very helpful in terms of its recommendations but that he wished it could have come forward sooner.

Structure of and Interactions within City Government

Mr. Romano asked Mayor Murphy whether there was any incentive for the City Manager to listen to what the Mayor had to say. Mayor Murphy explained that the City Manager served at the pleasure of City Council and, with five votes, the Council could fire the City Manager. Mayor Murphy noted that the Mayor or the City Manager had to line up support on Council to get their agenda through.

Mr. Romano asked Mayor Murphy about his and the Council's perception of Uberuaga. Mayor Murphy explained that his opinion "evolved from positive to negative." Mayor Murphy believed that Uberuaga did a good job during the Mayor's first year in office, but that he mishandled the labor negotiations in the Spring 2002. Mayor Murphy became disillusioned with Uberuaga's lack of strength in dealing with the labor unions, believing he "gave away too much" during Meet-and-Confer. Mayor Murphy was particularly frustrated with how Uberuaga dealt with the Police Officers Association ("POA"), with which the City had reached an impasse over certain benefits during the 2002 Meet-and-Confer. When the POA threatened a work stoppage the next year when the Super Bowl was held in San Diego, Uberuaga gave in and granted the POA higher benefits than the other unions had previously received. Once the financial statement error issue arose, Mayor Murphy had had enough of Uberuaga.

Mr. Romano asked Mayor Murphy how the Mayor's Office could ensure that the bureaucracy below the City Manager would be responsive to the Mayor's needs. Mayor Murphy explained that there was no way to ensure responsiveness and that it mostly came down to a combination of "trying to have good ideas and charm." Mayor Murphy explained that he maintained good relationships with certain departments and people and, overall, he did not believe that City staff were out to be obstructionists, though he hesitated somewhat in making the latter statement. Asked whether there was a way that City staff could effectively thwart him, Mayor Murphy responded affirmatively. Mr. Romano asked Mayor Murphy whether he believed that such an effort could have been behind City staff's failure to come up with a prompt solution to the pension funding issue. Mayor Murphy explained that he did not believe the disagreements among City staff were the result of bad faith but rather reflected that "they did not know what to do."

Mr. Romano asked Mayor Murphy about where ultimate responsibility in City government would have fallen for a funding shortfall. Mayor Murphy believed that it would have been seen as the fault of the City Manager. Mr. Romano asked Mayor Murphy whether the core group of City staff members he met with about the pension fund issue ever placed blame on themselves. Mayor Murphy stated that they did not, rather attributing the problem to the stock

market, the general economy, 9/11, the Chairman of the Federal Reserve and other economic-related forces. Overall, this perception led to the City's passive response to the problem.

Mayor Murphy also noted that City staff often blamed the pension problem on Jack McGrory (former City Manager during MP-1). Asked about his perception of McGrory, Mayor Murphy stated that he had a reputation for "hiding the ball from the Council." Mayor Murphy believed that McGrory thought that he was the CEO and the Council was just an entity he had to "trifle with" once in a while. Mayor Murphy held off on speculating about how McGrory actually worked with the Mayor and Council. Mayor Murphy explained that his impression of McGrory came from word of mouth; McGrory was admired, feared, distrusted and was tough. Asked why McGrory left City government, Mayor Murphy was not certain, but noted that he left soon after MP-1 was approved and the Chargers ticket guarantee was entered into by the Golding administration. Some people believed he left before everything fell apart while others believed he simply wanted to move higher up in government.

Budget Issues

Mr. Romano asked Mayor Murphy how considerations such as employee benefits and Meet-and-Confer would factor into the creation of the annual budget. Mayor Murphy explained that the City Manager would give Council the proposed budget on May 1, and the Council would have two months to make recommendations and reach a final consensus. Mayor Murphy noted that the City Manager might have sent him and the Council a memo a little while before presenting the budget, inquiring whether there were any particular projects in which Council members were interested, but there was little contact between Council and the City Manager beyond that.

Mr. Dahlberg had earlier asked Mayor Murphy whether the City Manager consulted with him and Council about budget proposals or just unilaterally dealt with budget issues. Mayor Murphy explained that the City Manager created budget binders with the proposed budget and asked Council members and the Mayor what changes they wanted to make. He noted that they could not challenge the City Manager on actual numbers (*i.e.*, what money there was to spend), but rather could only suggest different ways to allocate spending. In the end, Mayor Murphy explained, the budget was a combined product of Council and the City Manager.

Mr. Romano asked Mayor Murphy how one would find Meet-and-Confer items in the budget. Mayor Murphy explained that such issues were simply not in the budget, noting that there was "a lot of hide the ball from the Council" by the City Manager. If Council members did not know about a particular issue, they would not be able to look into it. Mayor Murphy noted that the Council made changes in 2005, bringing in an outside labor negotiator to work directly alongside the labor representatives from the City Manager's Office and keep the Council apprised of significant issues. However, in 2002, Mayor Murphy believed that he would have just assumed that the City Manager's budget would have had a number in it representing proposed labor costs such that they knew what they could offer during Meet-and-Confer (which likely was going on simultaneously). He stated that nothing in the budget that year would have shown them the impact of the benefit increases on the pension system. Mayor Murphy noted

that they were “rookies” then and Uberuaga “never told us and we were stupid enough not to ask.”

Mr. Romano asked what kinds of discussions he and the Council had about costs after the City Manager handed over the budget at the beginning of May. Mayor Murphy explained the Council would have Closed-Session discussions about the potential costs during labor negotiations. He explained that they would engage in a “costing out” of the salary benefits over the three-year period of the proposed plan, but that they did not consider the future impact of these costs beyond those projections. He believed this “costing out” information was contained in a document used during a Meet-and-Confer meeting.

Labor Negotiations and MP-2

Mr. Romano asked Mayor Murphy whether he could recall the first time he learned about MP-1. Mayor Murphy believed he first heard about it around March 2002 during a Closed-Session meeting. Mr. Romano showed Mayor Murphy an April 26, 2002 Closed-Session Agenda regarding Meet-and-Confer issues (Exhibit 8). Mr. Romano then showed Mayor Murphy a March 15, 2002 memorandum from Daniel Kelley (Labor Relations Manager) to the Mayor and Council with an attached PowerPoint presentation about Meet-and-Confer issues that was shown in Closed-Session (Exhibit 9). Reviewing the language on slide 66 of Exhibit 9 referring to the “Manager’s Proposal effective 1/97,” Mayor Murphy corroborated that this was likely the first time he learned about the MP-1 contribution rates.

Mr. Romano inquired about Mayor Murphy’s recollection of his understanding of MP-1 at the time, in particular considering that the BRC Report had just recently informed the Mayor and Council that the pension system was being under-funded on an annual basis. Mayor Murphy explained that he understood this connection now but did not necessarily connect the two concepts at the time. Mr. Romano inquired whether this disconnect derived from the perception that the BRC Report and pension problem was on a separate “track” than Meet-and-Confer and MP-2 issues. Mayor Murphy believed that that was an acceptable explanation in hindsight. However, at the time, he could only recall hearing about the “trigger,” that the funded ratio had dropped, that a large payment into the system would be necessary if the ratio dropped past a certain level and that “they would need to convince the Retirement Board to lower the trigger number.” Mayor Murphy noted that he was very busy at that time with the library project and other issues arising in Sacramento. Moreover, Mayor Murphy explained that, because he ran Closed-Session hearings, he would have to keep tabs on who wanted to speak, read notes that people were sending him, and keep the many “prima donnas” in check. Thus, it was difficult for him to focus on the substantive conversation taking place.

Mr. Romano asked Mayor Murphy whether there was any discussion at the meeting about how to respond to the problem of the trigger being approached. Mayor Murphy recalled that the City Manager was concerned about the budget and came up with the idea to lower the trigger. Mayor Murphy noted that some of the unions had expressed a willingness not to ask for salary increases. Mr. Romano asked Mayor Murphy how the lowering of the trigger and the employees’ retirement benefits were connected in his mind. Mayor Murphy stated that, “there was definitely a relationship in the increase of the retirement factor from 2.25 to 2.5 for public employees and lowering the trigger in March, April, May.” He believed that this

connection became "muddled" in later months, but "early on, there was definitely a connection." Noting that the SDCERS Board ultimately agreed in principle to restructure the contributions system in July 2002, Mr. Romano asked Mayor Murphy to clarify what he meant by "muddled." Mayor Murphy explained that his understanding of the Manager's Proposal "was that they would increase the retirement factor from 2.25 to 2.5 if the trigger was reduced to 75%. The Retirement Board rejected that, so they called the City Manager's bluff." Mayor Murphy understood that at that point, "it was a new proposal, a proposal to decrease the contribution levels in exchange for a ramp-up." Asked what were the advantages of a ramp-up, Mayor Murphy explained that it was "very valuable because it meant we would not have to make some huge balloon payment." He understood that it would gradually bring the City up to full actuarial funding. Mayor Murphy recalled that the City Manager described this plan as a solution.

Mr. Romano inquired whether there was any expectation that the Memoranda of Understanding with the labor unions and the City's contribution relief would all be finalized before June 30, 2002. Mayor Murphy could not recall this expectation being explicitly stated but that there may have been some "implicit suggestions" to that effect. Mr. Romano showed Mayor Murphy a June 23, 2002 e-mail from Councilmember Byron Wear to Cathy Lexin (Human Resources Director), Mayor Murphy, Council members, and a number of City officials -- Casey Gwinn (City Attorney); Elmer Heap (Head Deputy City Attorney); Leslie Devaney (Assistant City Attorney); Girard; Uberuaga; and Lamont Ewell (Assistant City Manager) (Exhibit 10). After explaining that this e-mail may reflect Councilmember Wear's frustration with Lexin for not assuring the City contribution relief before granting the labor unions increased benefits, Mr. Romano asked Mayor Murphy whether he recalled this sentiment being discussed in Council. Mayor Murphy became a bit frustrated at this point, stating that "this was Uberuaga's thing." Mayor Murphy explained that the City Manager was supposed to handle labor negotiations and the Council would just give feedback and ultimately approve the City Manager's decisions. He stressed that the Council was busy with other matters and Uberuaga was supposed to have taken care of this labor issue.

Asked why Councilmember Wear was paying close attention to this matter, Mayor Murphy explained that he did not know and acknowledged that he may have been projecting his own feelings upon other Council members. Noting that he had not seen this e-mail until recently, Mayor Murphy reiterated that he just listened to the City Manager at the time. Still, he noted that he was also upset with the City Manager at this point because he thought Uberuaga "had given away the whole store." Mayor Murphy was somewhat uncertain about the timing of these benefit increases.

Mr. Romano showed Mayor Murphy a July 8, 2002 memorandum from Lexin and Heap to the Mayor and City Council regarding contingent retirement benefits and the modification of the pending Manager's Proposal (Exhibit 11). Mayor Murphy could not recall receiving this memorandum at the time, but suspected that he did see it. Mr. Romano directed Mayor Murphy's attention to the language on page 2 regarding Lexin and Heap being "optimistic" about a favorable report from the SDCERS Administrator (with regard to the modified proposal) and their anticipation of a SDCERS Board member making a motion to approve the modified proposal. Mr. Romano asked Mayor Murphy whether he knew to which "member" they were referring. Mayor Murphy stated that he did not know at the time, though he knows now the remark was in reference to Ron Saathoff. Asked whether there was any

discussion within Council as to what these statements meant, Mayor Murphy could not recall any discussion on the subject. Mr. Romano asked Mayor Murphy whether it would have struck him as awkward that he would receive a memo with such a prediction. Mayor Murphy simply noted that he could not recall the discussion in this Closed-Session meeting except for the fact that they were giving up on obtaining the 75% funding floor. Mayor Murphy again stated his frustration with Uberuaga, in particular as to his handling of this proposal. Noting that the Rules Committee or Council was expecting to hear back from SDCERS at this point, Mr. Romano inquired whether that was also in the Mayor's mind. He stated that it was not.

Noting that the March 2002 Meet-and-Confer PowerPoint presentation had put him and Council on notice as to the trigger issue, Mr. Dahlberg asked Mayor Murphy whether the fact that a breach of the trigger would not have affected the City's contributions until FY2003 factored into their thinking at the time. Mayor Murphy explained that they realized that, due to the economic downturn, they would have trouble balancing the budget that June. Mayor Murphy explained that his concern with Uberuaga was that he was "awfully short-sighted" in granting the huge benefits that Spring.

Mr. Dahlberg asked Mayor Murphy whether he believed that the combination of the trigger and the increase in benefits leading up to the budget date was a potential disaster. Mayor Murphy did not believe so, as he acknowledged his understanding that if the trigger was hit, the effect would not have been felt for a full year. In hindsight, the Mayor believed that the City should have only entered a one-year labor agreement in 2002 rather than a three-year one, as there were too many uncertainties surrounding the City's finances at the time. Mayor Murphy believed the decision to do so "was a little foolish."

Regarding the SDCERS Board indemnification resolution that accompanied MP-2, Mr. Romano asked Mayor Murphy whether there was a sense that the provision was necessary at that time. Mayor Murphy recalled the notion that "it was demanded from the Retirement Board," though he could not remember specifically being told this. He recalled the SDCERS Board balking at the terms of MP-2 after the City had granted increased benefits and that one of the conditions of the "contractual relationship" (presumably, the entering of MP-2) was that the Board be indemnified. Mayor Murphy clarified that he recalled the SDCERS Board representing to him and the Council that they would approve MP-2 if they had proper indemnification.

Mr. Romano showed Mayor Murphy the minutes of the November 18, 2002 City Council meeting at which the MP-2 ordinance and the indemnification resolution were approved (Exhibit 12). Directing Mayor Murphy's attention to Item-33 on page 39 of the minutes, Mr. Romano noted that there was nothing in the approval of the indemnification resolution that indicated it was part of the overall MP-2 agreement. Mayor Murphy acknowledged this point, noting that he must have projected his flawed understanding of the provision onto his recollection of the agreement.

Mr. Romano asked Mayor Murphy whether anyone at the time raised the issue that there might be a conflict of interest problem for City employees sitting on the SDCERS Board. Mayor Murphy explained that no one did, even though they "had six City attorneys sitting in on all of these Closed-Session meetings." Mayor Murphy listed the members of the City Attorney's Office that he could recall were usually at Council meetings: Gwinn; Heap;

Girard; Devaney; Michael Rivo (Deputy City Attorney); and Sharon Marshall (Deputy City Attorney). Mayor Murphy stated that, "if Les Girard had stood up at any point and said he thought there was anything illegal here, they would not have proceeded." Mayor Murphy noted that Girard did a great job on many different matters and, on the whole, was an otherwise effective Deputy City Attorney. Mr. Romano asked Mayor Murphy about his perception of the City Attorney's Office's handling of the *Gleason* litigation and settlement. Mayor Murphy acknowledged that there was some merit to the argument that under-funding was illegal and this was never mentioned to Council in 2002.

Shipione Allegations

Mr. Romano asked Mayor Murphy about his recollection of his reaction to Diann Shipione's November 18, 2002 letter addressed to him and Council alleging that the entering of MP-2 was illegal. Mayor Murphy stated that "surprised would be a bit of an understatement." He recalled that this was the first time he became aware that she disagreed with the proposal. Mr. Romano asked Mayor Murphy whether he recalled Shipione characterizing the contingent element of the proposal as "blatantly corrupt," to which Mayor Murphy responded that he was "shocked" by that language. Mayor Murphy explained that were it not for her tone, he may have believed that there was more substance to her allegations. Mayor Murphy recalled that they referred her allegations to the City Manager for a response, noting that "in twenty-twenty hindsight, they should have referred it to the City Attorney for a response."

Mr. Romano asked why Ewell prepared the response rather than Uberuaga. Mayor Murphy did not know at the time, but subsequently heard that Uberuaga asked Ewell to do it because he did not want to prepare it himself. Mayor Murphy could not be sure where he heard this, but noted that much of his knowledge comes from the V&E Reports. Asked whether he gave the City Manager's Office any specific direction in crafting a response, Mayor Murphy explained that the Council just handed off the issue.

Mr. Romano asked Mayor Murphy whether he read Ewell's response to Shipione's November 18, 2002 allegations. Mayor Murphy recalled that he was aware of Ewell's response but was not certain that he read it. Asked whether he believed Ewell's response was dispositive of the issue, Mayor Murphy stated, "I accepted that as correct at the time; I didn't compare them at the time." Though Shipione's letter was attached to Ewell's response, Mayor Murphy noted that he doubted he read her letter at that point (in early December 2002).

Mr. Romano asked Mayor Murphy whether he ever spoke with Shipione. Mayor Murphy recalled speaking to her once, but he was not certain that their discussion was in connection with her November 18, 2002 letter. He explained that he saw her at a dinner held for President George W. Bush, at which she "apologized" to Mayor Murphy for what she was doing. Mayor Murphy recalled that he told her, "you have to do what you have to do." Asked about his impression of Shipione, Mayor Murphy noted that he assumed her allegations had something to do with his "unfortunate relationship with her husband [Pat Shea]." Mayor Murphy explained that he initially believed she was generally sincere, but that he began to view her motives differently when she publicly challenged him for not appointing any African-Americans to the SDCERS Board, despite the fact that he only appointed four out of the Board's thirteen

members. After that episode, Mayor Murphy explained that he “discounted what she said as kind of politically motivated.”

Mr. Dahlberg asked Mayor Murphy whether he recalled discussing Shipione’s allegations with any of his staff members. Mayor Murphy could not recall specific discussions, but believed he would have consulted with Kern or Gibson about this issue. Inquiring about how a consensus developed dismissing Shipione’s concerns, Mr. Haegele asked Mayor Murphy how he reconciled the sentiment among Girard and other City staff members that Shipione was “crazy” with the detail and comprehension of Shipione’s letters. Mayor Murphy explained that there was a lot of dissension from her views on the SDCERS Board and that she was known to have created internal strife on the Board. Mayor Murphy stated that Council believed her motive for causing this discord derived from her anger about her husband getting “trashed” in the Brownfields project matter. Mayor Murphy noted that he had officiated Shipione and Shea’s wedding, so they had believed the Mayor was “in their pocket” with regard to the approval of the project. Mayor Murphy believed that he “deeply disappointed them” when he vetoed the project.

Mr. Haegele asked Mayor Murphy whether Ewell’s response would have been different if someone other than Shipione had come forward with the allegations. Mayor Murphy speculated that the Council would have likely looked into the issue “more deeply” if the allegations had been brought forward by someone like Vortmann. Asked whether the matter would have been referred to Ewell or dealt with differently if such were the case, Mayor Murphy declined to comment as such would have been mere speculation.

Mr. Dahlberg asked Mayor Murphy whether it ever occurred to him or the Council not to vote on MP-2 at the November 18, 2002 meeting until Shipione’s allegations were examined and answered. Mayor Murphy was not certain whether this approach was considered, noting that the measure that Shipione opposed was just the introduction of the ordinance rather than its actual adoption. Thus, he believed, the Council would have two weeks to consider the provision before it was actually adopted. Asked whether he recalled the sentiment among Council members that they needed to pass the measure without delay, Mayor Murphy believed that the City Manager tried to push it through. At this point, Mr. Romano directed Mayor Murphy’s attention to the minutes of the November 18, 2002 meeting (Exhibit 12) and pointed out to Mayor Murphy that the ordinance was actually approved at this meeting as Item-50. Mayor Murphy explained that this was just the approval of the benefits provision. It should be noted that Item-50 was, in fact, the approval of the MP-2 Ordinance. It contained both the increased benefits amendments to the Municipal Code *and* the incorporation into the Municipal Code of the Memorandum of Understanding regarding the gradual ramp-up of contribution rates. Mr. Romano pointed out that the indemnification resolution was approved at this meeting as Item-133. Mayor Murphy acknowledged this fact, noting that since this was just a resolution, it was not as final as an ordinance at that point.

Presidential Leave

Mr. Romano asked Mayor Murphy about his general recollection of the Presidential Leave benefit. Mayor Murphy recalled that the presidents of the MEA and the POA had been able to use their union salaries toward the calculation of their pension benefits, a benefit which Saathoff (Local Union 145) had yet to receive. Mayor Murphy believed that

Saathoff did not find out about this state of affairs until 2001. Mayor Murphy explained that this issue was presented by him and to the Council as a "fairness issue." He recalled some discussion about them being sued about it, but he did not really understand the basis for such a claim. Asked whether the impetus for this benefit came from the union- or City-side of the labor negotiations, Mayor Murphy recalled it was proposed and pursued by the unions.

Mr. Romano showed Mayor Murphy an October 24, 2003 agreement between the City and Saathoff (signed and dated by the City Attorney on December 12, 2003) memorializing Saathoff's Presidential Leave benefit (Exhibit 13). Mr. Romano asked Mayor Murphy whether he recalled the aspect of Saathoff's Presidential Leave agreement that allowed him to convert annual leave that he had accrued as of July 2002 into service credit for the purposes of calculating his pension benefit. Mayor Murphy could not recall this element nor having ever seen this particular agreement before. Mr. Romano asked whether this type of agreement would have had to been approved by the Council. Mayor Murphy explained that the City Manager had the authority to enter into agreements up to a certain expenditure amount without the Council's approval (\$250,000). He also noted that the annual Salary Ordinance contained many different aspects and could have made legal this particular agreement on its own. Mr. Romano asked whether it was possible that, at the time this agreement was entered, someone could have raised concerns with Mayor Murphy that conferring such a benefit could be improper. Mayor Murphy stated that he did not think this issue was raised with him.

Ron Saathoff

Mr. Romano asked Mayor Murphy whether he believed Saathoff was important to the SDCERS Board. Mayor Murphy noted that he was not certain about SDCERS Board dynamics, as he was somewhat distanced from the Board's activities. He later stated that he only attended a SDCERS Board meeting one time to request the waiver of the Board's attorney-client privilege for the purposes of the recent investigations. Still, Mayor Murphy explained that Saathoff "was just an influential guy, wherever he was," both "because of his personality and his position." Mr. Romano asked Mayor Murphy whether he had a sense of Saathoff's honesty. Mayor Murphy could not recall hearing or encountering anything that would have made him doubt Saathoff, specifically noting that Saathoff was a member of his Rotary Club and would have had to get past the somewhat demanding screening process. After Mayor Murphy noted that Saathoff was just "aggressive," Mr. Romano pointed out that that characterization sounded like a euphemism for "brutal." Mayor Murphy clarified that he would best describe Saathoff as "assertive." Asked whether he looked forward to or dreaded meetings with Saathoff, Mayor Murphy stated that Saathoff was "kind of likable," noting that the only hesitation he had about his personality was his belief that Saathoff may have been posturing in social interactions to forward his union agenda.

Mr. Dahlberg asked Mayor Murphy about what base of influence Saathoff would have had at the time. Mayor Murphy explained that Saathoff had influence both through his position on the SDCERS Board and his representation of firefighters, a group that was particularly admired after a series of wildfires hit the City in 2003. Unlike the POA, which was seen in a bad light after the police officers' threat of a strike before the 2003 Super Bowl, Local Union 145 (and thus Saathoff) had a lot of leverage.

Legislative Officers' Retirement Plan

Mr. Romano asked Mayor Murphy whether he recalled the November 2001 Manager's Report recommending that the changes to the Legislative Officers' Retirement Plan ("LORP") made in September 2000 -- among other things, changing the pension vesting age for elected officials from 60 years of age to 55 -- be made retroactive for all eligible members before September 2000. Mayor Murphy recalled this issue, noting that he had specifically obtained an opinion from the City Attorney -- because of his previous service as a Council member -- stating that he would not have a conflict of interest in voting for this recommended proposal. Mr. Romano asked why this would not have presented a conflict for him, as it would have changed his benefit calculation for his service between 1981 and 1985. Mayor Murphy explained that the City Attorney had told him that his service as a Council member and then later as Mayor would have been considered continuous service because he did not officially retire. Asked where the idea for this proposal came from, Mayor Murphy believed that Mike Gotch (former City Council member and, at the time of contact, Legislative Aide to Governor Gray Davis) had contacted him about pursuing the retroactivity provision. Mayor Murphy speculated that Councilmember Madaffer may have proposed the January 2002 vote.

Mr. Romano asked Mayor Murphy whether there was any discussion surrounding the January 2002 provision about the potential impact of this benefit increase for former elected officials on the City's finances. Mayor Murphy could not recall any such conversations and stated that it was probably not discussed. Mr. Romano explained to Mayor Murphy the City Charter provision mandating that SDCERS plan participants work for ten years and attain the age of 62 before their pensions vest. Mr. Romano explained that Proposition C -- which would have changed the above requirements to five years and the age of 55, respectively -- was rejected by the voters in January 2002 before Council approved the retroactivity provision. Mr. Romano asked Mayor Murphy whether anyone on the Council or City staff suggested that there may be a conflict between the LORP amendments and the City Charter provision. Mayor Murphy responded that he understood this issue in great detail, as City Attorney Michael Aguirre had sued him and other elected officials who benefited from the benefit increase in September 2005 (the case was later dismissed). Mayor Murphy explained the progression of the changes to LORP and the opinions surrounding those changes, most notably the City Attorney's Opinion in 1992 concluding that the Charter requirements did not specifically apply to elected officers. Asked why the case was dismissed, Mayor Murphy explained that the judge had doubted the strength of Aguirre's case and Aguirre soon thereafter dismissed the case without prejudice.

Purchase of Service Credit

Mr. Romano asked Mayor Murphy whether he had ever purchased "air time." Mayor Murphy stated that he purchased five years over a two and one-half year period starting in 2002 and ending in 2004. Asked how he went about doing this, Mayor Murphy explained that he contacted Lawrence Grissom (SDCERS Board Administrator) or Paul Barnett (Assistant SDCERS Board Administrator) directly, who handled the logistics of the contract. Mayor Murphy noted that if Council members wanted to purchase service time, they would generally contact either Grissom or Barnett. Mayor Murphy explained that they told him how much it would cost, noting differences in the rate based on what type of payment plan he used. After

Mayor Murphy informed them he wanted to pay for the plan over a two and one-half year period, they took the payments directly out of his paycheck.

Mr. Romano asked Mayor Murphy about what prompted him to purchase the service time when he did. Mayor Murphy explained that, by cutting short his career as a judge when he ran for Mayor, he had given up 25% of his possible maximum retirement benefit. He decided that he would try to bring up his City pension to compensate for the loss in his State benefits.

Mr. Romano asked Mayor Murphy whether he understood how the program worked, to which Mayor Murphy responded that he believed it was priced on a cost-neutral basis. He could not recall who had told him that. Mr. Romano showed Mayor Murphy a February 10, 2003 e-mail from Terri Webster (Assistant City Auditor & Comptroller) to Baber, Gibson and Kern (Exhibit 14). Mr. Romano directed Mayor Murphy's attention to the bottom of the e-mail where Webster informed the Mayor's staff members that the Purchase of Service program was being knowingly operated by the SDCERS Board at a loss. Mayor Murphy stated that he became aware of this state of affairs at some point, but could not recall exactly when. He remembered that he received a letter from the City Manager that stated the City would "stop selling at a discount," but that he never saw this particular e-mail. Asked whether he recalled discussions about the Deferred Retirement Option Program ("DROP"), which is the subject of the first half of Webster's e-mail, Mayor Murphy could not recall specific discussions but remembered that DROP was also a very controversial issue at the time. He believed that both of these issues -- under-priced Purchase of Service program and DROP -- had been controversial later than February 2003.

Ballpark Offering and Disclosure Issues

Mr. Romano asked Mayor Murphy whether he received any formal training regarding his general duties as Mayor when he first took office. Mayor Murphy explained that he did not, though he asked the City Manager's Office to arrange a three-day orientation seminar about what each City department and office does. This program was not so much for training as it was an explanation of City operations. Asked whether he received training on how the City raised and spent money, Mayor Murphy explained that they did not receive training about bond disclosures and related issues but rather had to learn about these matters on the job. Mr. Romano asked Mayor Murphy whether he understood that the ballpark project would be publicly funded in part. Mayor Murphy noted that he did understand this.

Mr. Romano showed Mayor Murphy a November 6, 2001 memo from Girard to the Mayor and City Council with an attached letter from Bryan Cave discussing the due diligence duties of Council members in connection with the review of the Ballpark bond offering statement (Exhibit 15). Mr. Romano asked Mayor Murphy whether he recalled Girard or anyone else discussing this letter in Closed-Session. Mayor Murphy could not specifically recall the letter but remembered that Girard and another attorney spoke generally to him and the Council about how the City planned to handle the ballpark offering. Asked whether he could recall them discussing the requirements of the federal securities laws, Mayor Murphy stated that he did not remember this meeting this way. Rather, he recalled that the City anticipated that Bruce Henderson -- a lawyer that had filed a number of lawsuits relating to the ballpark project --

threatened to file a complaint with the SEC or bring his own securities fraud action as to the ballpark bonds. The Closed-Session meeting was devoted to addressing how to deal with such an action. Since this would have been a new type of action relating to the project, it was presented to Council that one way of dealing with this matter would be to have a "bulletproof set of documents."

Directing Mayor Murphy's attention to the contents of the letter, Mr. Romano asked him whether any of the speakers during the meeting recited or described the letter to them. Mayor Murphy could not recall what was actually said at the meeting, reiterating that all of the managerial duties he had during Closed-Session meetings clouded his memory of the substance of these meetings. Mayor Murphy vaguely recalled that someone directed them to read the Preliminary Official Statement ("POS") and make sure it was accurate. Mr. Romano explained to Mayor Murphy that our current understanding of this letter and meeting was that they were used to create a record to use as evidence of disclosure compliance for a potential lawsuit. Mayor Murphy agreed with this conception of the meeting's purpose, noting that Girard should be given credit for making this type of effort to help protect the ballpark bonds. Asked whether anyone asked questions at the meeting about certain issues raised in the Bryan Cave letter, Mayor Murphy stated that he could not recall any particular questions asked at the meeting.

Mr. Romano asked Mayor Murphy how he ultimately addressed the issue of disclosure surrounding the ballpark bond offering. Mayor Murphy explained that he and the other members of the Council decided that they should read the offering statement and be prepared for potential litigation. Mr. Romano showed Mayor Murphy the February 14, 2002 Ballpark Bond Offering Statement (Exhibit 16). Mr. Romano asked Mayor Murphy how he would have approached reading this particular offering statement, in particular what he would have been looking for. Mayor Murphy recalled that he was told to look for "inaccuracies" so that if the City was attacked for the offering statement being misleading, he and the Council members could say that they read through it and thought it was accurate. Mayor Murphy believed that he would have read the POS in November 2001, before the bond issuance was approved. Asked whether there were particular sections that he focused upon, Mayor Murphy stated, "by logic, I think you would read the first section closer than the appendices." He believed he read the appendices "probably a little less thoroughly." As Mayor Murphy began to use the pronoun "we," Mr. Romano asked him to clarify who he meant to include. Mayor Murphy stated that he meant the other Council members, but then backed off from including them, as he was not certain that they had also read the offering statement. He could not recall having discussions with other Council members about how they approached reading the offering statement.

Mr. Dahlberg asked whether the Closed-Session presentation made in connection with the ballpark offering was atypical of how other offerings were approached. Mayor Murphy noted that, up until that time, he and the new members of Council would have only approved Tax Anticipation Note Series ("TANS") bond offerings and thus had no basis for comparison. Mr. Dahlberg asked Mayor Murphy whether there was any sense that the CAFRs also needed to be examined closely. Mayor Murphy stated that Council did not have to approve CAFRs, so they would never see these financial statements before they were issued. Mayor Murphy later explained that this was the system that he inherited when he took office. Mr. Dahlberg asked Mayor Murphy whether he and Council would receive financial reports relating to the budget

using information from the previous year's CAFR. Mayor Murphy explained that they would receive the previous year's financial projections, expenses and predictions for the upcoming year. However, they did not receive information that would have been stated in a balance sheet, which he understood would have been in the CAFR.

Mr. Dahlberg asked Mayor Murphy whether he had an understanding that the City CAFRs were tied into the bond offering statements. Mayor Murphy was aware that the CAFR was an appendix to bond offering statements, but believed that he would not have read that part of the offering statement very closely. Pointing out that the CAFRs had a lot of textual information in addition to the financial reports, Mr. Haegel asked whether Mayor Murphy would read those aspects of the CAFRs in the bond offering statements. Mayor Murphy stated that he believed he did not read those portions of the offering statement. After Mr. Dahlberg posited the analogy that the Mayor and Council members, like directors on the Board of a corporation, have the obligation to ensure that the financial statements of the City are accurate and forthcoming, Mayor Murphy stated that it was not considered part of the duty of the Mayor and Council members to read the financial statements of the City and it was never suggested that it was his responsibility.

Mr. Dahlberg sought clarification that the Bryan Cave letter was not considered a long-term type of approach to how Council members should approach future financial statements. Mayor Murphy corroborated this view, noting that the attitude of the Council toward the review of a particular offering statement was based on how controversial the particular offering was. He stated that he -- and other Council members, he believed -- would not read TANS offering statements, as they were routine and issued on an annual basis. As to his personal approach for most bond offerings, Mayor Murphy explained that he would read the Manager's Report about that particular offering and flip through the pages so he could make sure everything was there. Unless he saw something particularly interesting, he would not read the offering statement more closely. He noted that he also looked through some of the "back-up" material for the offering statements.

Ms. Naughton clarified that there is some confusion as to what City Council is shown for approving a particular offering. She explained that Council is presented an ordinance that if approved would direct the final approval of the POS. After the POS was approved, the CAFR would be added as an appendix. She explained that, in essence, the Mayor and Council members were just voting on an ordinance or resolution and may have not even had the accompanying POS in front of them when voting on certain occasions.

Mayor Murphy could not recall having the "back-up" in front of him during the vote over the ballpark bonds; rather, he recalled only seeing the Manager's Report and the POS.

Mr. Romano asked Mayor Murphy where in this overall process he and Council would have received assurances from outside bond counsel that the disclosure statement was accurate. Mayor Murphy explained that they would have been informed by disclosure counsel or bond counsel (he seemed to believe that these were separate) by the time they voted to approve an offering. Mr. Romano asked Mayor Murphy whether these opinions would have been in the "back-up" materials. Mayor Murphy was not certain, noting that he just relied on the City Manager and the City Attorney's Office that had been issuing bonds for years. Mayor Murphy

also stated that staff members in the City Auditor & Comptroller's Office were a resource, as they had been involved with bond offerings for many years. Mayor Murphy recalled that disclosure counsel would usually be present at the meeting at which an offering was approved.

At this point, Mr. Romano sought clarification of how the bond offering approval process worked, in particular how the Council would be informed that disclosure counsel had actually read the POS. Mayor Murphy explained that he would be aware that the disclosure counsel was writing an opinion and that the City Manager was conducting some type of accuracy check, but he could not be certain that either of these activities would have been documented in the "back-up" materials for a POS vote. Mayor Murphy reiterated how he relied on all of the "high-paid professionals" on which they thought they could rely. He explained that the Council members did not have the technical knowledge to understand these complex issues; rather, their job was to examine the overall policy issues as to whether the offering itself was prudent. Ms. Naughton suggested that we acquire the Form 1472 sheets that demonstrate all the offices and officials that signed off on any given bond offering.

Mr. Dahlberg asked about the accessibility of the Bryan Cave letter, in particular how long he and Council members had to examine the letter before and during the Closed-Session meeting. Mayor Murphy explained that Closed-Session materials were supposed to be passed out on the Friday before a Tuesday Closed-Session meeting but often were not given to the Council members until immediately before the meeting. All the materials at Closed-Session meetings were taken back at the end of the meeting. Mr. Romano asked Mayor Murphy whether he could retrieve certain materials after a meeting if he had taken a particular interest in them. Mayor Murphy explained that they could generally look at the materials again, but would have to do so in the presence of the City Attorney's Office (usually Girard) and give a back after reviewing them. He explained that the City was very guarded about "sensitive" things being leaked.

Wastewater

Mr. Romano showed Mayor Murphy a January 29, 2002 Closed-Session Report for a meeting held that day (Exhibit 17). Asked what he recalled about this Closed-Session meeting, Mayor Murphy explained that the City Attorney or staff raised some confusing issues about Proposition 218 and the City's sewer rates, and this presentation morphed into a discussion about whether the City should do a Cost of Service ("COS") study to satisfy the State Water Resources Control Board ("SWRCB"). Mr. Romano inquired about why a COS study would satisfy the SWRCB, to which Mayor Murphy responded that this was the first time he and the Council were informed that their sewer rate structure did not comply with state law. Asked why the sewer rates violated state law, Mayor Murphy explained that he now understood the specific details of this issue because of the changes made in June 2004 but that he did not understand at all at that time.

Mayor Murphy could not clearly remember who gave the presentation at this meeting, but believed that it was probably Dennis Kahlie (City Utilities Finance Administrator) because he typically dealt with the sewer rate issue. Asked whether he could recall the Council's reaction to the presentation, Mayor Murphy believed that most members were surprised. Mayor Murphy believed there was some "hostility" among several members of the Council for several

reasons. First, he noted that he had just pushed through raises in the sewer rates, so members of the Council were upset that they were just hearing about this sewer rate allocation issue afterwards. Second, Mayor Murphy believed that members of the Council perceived this issue as "another unfunded mandate from the State," *i.e.*, the State again trying to force the City to take an action for which the State would not provide funding.

Mayor Murphy expanded on the issue of the sewer rates adjustment, explaining that he and the City Manager had created a plan when Mayor Murphy first took office to raise both the sewer rates and water rates in strategic fashion. They decided that they would try to raise sewer rates in 2001, in particular addressing all of the high-profile sewer spills of recent years. Mayor Murphy noted that Councilmember Peters was also an advocate of these sewer rate increases. They also believed that water rates needed to be raised because of problems with the City's pipe system, and planned for these rate increases to come in 2002. Considering their plan, Mayor Murphy described the rate allocation issue as a "bombshell," in that it would ruin their strategy to space out these rate increase hearings. Asked whether he understood the difference between the rate increase and rate structure issues, Mayor Murphy explained that he understood the difference now but was not certain that he understood it at the time. He believed he understood that, by changing the rate structure, some people's rates would go up while others' would go down.

Ms. Blaskey later asked Mayor Murphy whether he could recall if there was any action taken on the sewer rate structure issue at the January 29, 2002 Closed-Session meeting. Mayor Murphy responded that the City Attorney was directed to provide Council with a written analysis as to whether the City was required to conduct a COS study. Asked whether there was a timeline for the City Attorney's written report, Mayor Murphy could not recall whether that issue was discussed at the time, noting that he *personally* did not want the issue to come back to them before the water rate increase scheduled for later that year. Asked whether he communicated this sentiment to anyone, Mayor Murphy recalled he probably discussed it with the City Manager based on their original plan to raise water rates in 2002. He believed that he likely questioned the City Manager as to why he was putting this issue in front of the Council early in 2002.

Mr. Romano asked Mayor Murphy whether he recalled having any discussions with Councilmember Donna Frye about the rate structure issue. Mayor Murphy recalled that there were four distinct issues: sewer rates; sewer hook-up fees; water rates; and water hook-up fees. He explained that he and Councilmember Frye agreed that the hook-up fees needed to be at full-cost recovery and that the City was subsidizing some of the users at that point. They agreed that a COS study needed to be conducted on that issue. He recalled that she believed there should have been studies on all four issues. Asked whether he recalled having any discussions with Councilmember Frye about whether these studies should be published or discussed at public hearings, he could not recall such a conversation. Mr. Romano asked Mayor Murphy whether he was aware, at the time of the January 2002 meeting, that a COS study had already been conducted. He recalled that he did not understand at the time that a COS study was underway, but had come to learn that fact recently.

Mr. Romano showed Mayor Murphy a November 18, 2002 e-mail from Kahlie to Frazier with an attached "Salient Points" memorandum discussing sewer rate compliance issues (Exhibit 18). Directing Mayor Murphy's attention to the text of the e-mail, in which Kahlie

indicates that Frazier would be giving the memorandum to Kern, Mr. Romano asked Mayor Murphy whether he recalled seeing the memorandum. Mayor Murphy recalled seeing it, but could not be certain at what time. Ms. Blaskey pointed out that the memorandum went through several different drafts, so he may have not actually seen the version attached to this e-mail. Mayor Murphy asked who drafted the memorandum and Ms. Blaskey responded that Kahlie did. Mayor Murphy asked whether it was used in conjunction with a presentation, and Mr. Romano and Ms. Blaskey stated that they did not know.

Mr. Romano showed Mayor Murphy a November 14, 2002 memorandum from Mary Vattimo (City Treasurer) and Kelly Salt (Deputy City Attorney) to the Mayor and City Council (Exhibit 19). Mayor Murphy recalled seeing this memorandum and believed it was the written response he had requested from the City Attorney's Office at the January 29, 2002 Closed-Session meeting. He could not recall when exactly he received it. Mr. Romano explained to Mayor Murphy that the issues discussed in the memorandum were set to be discussed at a Closed-Session meeting on November 19, 2002 but that the meeting was cancelled. Mayor Murphy inquired as to why the meeting was cancelled, and Mr. Romano clarified that he believed the item was just taken off the docket. Asked whether they had approved the water rate increase at this point, Mayor Murphy stated that they had. Mr. Romano asked Mayor Murphy why he believed this may have been withdrawn from the docket. Mayor Murphy did not know, but speculated as to several potential explanations. He explained that even if an item was on the docket, it was not uncommon for things to be bumped, as Closed-Session was the last thing in line during a "Council week" (before the actual Council meeting). He also explained that the second half of Closed-Session meetings were sometimes cancelled. Asked whether a bumped item would be heard at a later date, Mayor Murphy noted that it usually would. Mayor Murphy explained that the City Attorney basically controlled Closed-Session and, though the Mayor had a veto over the City Attorney's decisions, he usually deferred to the City Attorney's judgment on such matters. Mr. Romano inquired as to when this issue was ultimately heard in Closed-Session. Mayor Murphy was not certain but recalled that the COS study was ultimately conducted between January and December of 2003. He did not have a recollection of approving an "update," noting that it was not clear to him that a COS study had been conducted before. Ms. Blaskey asked Mayor Murphy whether Council would have had to have approved the "update" if it cost less than \$250,000. Mayor Murphy noted that the City Manager would have made that decision on his own.

Mr. Romano asked Mayor Murphy whether, from his perspective after the water rate increase had already been secured, there was any reason to oppose the modification of the sewer rate structure. Mayor Murphy responded that he could not think of a reason. Mr. Romano explained how the COS study about rate allocation could negatively impact large users and asked whether Mayor Murphy recalled any concerns about political fallout over this issue. Mayor Murphy did not think so. He noted that the restaurant association was already struggling after 9/11 and he spoke with them often about their financial problems. Mayor Murphy explained that no one really knew how the COS study would "cut" in terms of who it would impact the most, as they had not seen a draft of a COS study at that point. Asked about his interactions with Kelco, Mayor Murphy could not recall having conversations with the company until 2004, when the decision to comply was imminent.

Mr. Romano showed Mayor Murphy a video recording of the May 14, 2002 City Council meeting at which Councilmember Frye requested the release of a May 2002 COS study and Mayor Murphy responded by shaking his head and stating that he had no knowledge of such a study (Exhibit 20). After showing Mayor Murphy the recording by way of a compact disc on a laptop, Mr. Romano asked him what he was thinking during the exchange at this Council meeting. Mayor Murphy believed that he was reluctant to discuss the issue informally in Open-Session because it pertained to the January 29, 2002 Closed-Session meeting, the substance of which was supposed to be maintained as confidential. Mayor Murphy speculated that he appeared silent during Councilmember Frye's inquiry because he believed the City Manager was going to respond. When the City Manager did not answer Councilmember Frye's question, Mayor Murphy had to "cover it up." Mayor Murphy believed that it had been decided at the January 29, 2002 meeting that the City Attorney would study the sewer rate structure issue and that Council would not have to deal with it during the interim. Mr. Romano asked Mayor Murphy whether he recalled any earlier meetings during which Councilmember Frye had asked for a COS study to be discussed in open. Mayor Murphy pointed out that, with regard to her comment during the May 14, 2002 meeting that the City had promised to conduct a COS study in connection with the October 2001 sewer rate increase, he could not recall that promise being made.

Mr. Romano asked Mayor Murphy whether he was aware of any disagreement between Councilmember Frye and Gwinn about the use of the Closed-Session mechanism around November 2002. Noting that he was speculating, Mayor Murphy believed that Councilmember Frye felt that all sewer, water and COS study issues should be dealt with in Open-Session. Mayor Murphy agreed with Mr. Romano's statement that the usual reason for Closed-Session was to avoid litigation, but noted that the real concern with the sewer rate issue pertained to the effect of Proposition 218. The state loan compliance issue only arose as a tangent to the Prop 218 issue, which was very much public. Mayor Murphy pointed out that there were four COS studies being considered at the time, so he had a hard time keeping the issue straight in his mind now as to which were actually issued and which were discussed in Closed-Session.

Mr. Romano showed Mayor Murphy a November 22, 2002 memorandum from Ewell to the Mayor and City Council with an attached draft of the May 2002 Black & Veatch COS study (Exhibit 21). Mayor Murphy acknowledged that the attachment was the draft of the COS study that had apparently been started earlier in 2002, noting that he was just reconstructing this time frame in his head because he was not aware of this memorandum and attachment at the time. He could not remember when this COS study was actually considered. Directing Mayor Murphy's attention to page 6-1 of the Draft COS study, Mr. Romano explained that the COS study made it rather clear that the City must comply with the SWRCB requirements. Mayor Murphy acknowledged this fact but again stated that he was not certain as to when he actually came to understand this. He noted that he was also told about these requirements by Salt -- though he was not sure when -- but that it was not clear that the State was serious about the conditions. He wanted to make sure the State actually "meant it" before the City complied. Mr. Romano directed Mayor Murphy's attention to page 2-1, reading the language that states, "[c]onsistent with revenue program requirements, SWRCB is mandating that the City modify its existing cost allocation basis and include the COD parameter in its rate structure." Mayor Murphy stated that he was pretty certain that he did not see this study in May 2002 and could not

recall seeing it in November 2002, pointing out that Story would have received this memorandum and attachment at that time.

Mr. Romano asked Mayor Murphy whether he was aware of the Stakeholder's Group when he took office in 2000. Mayor Murphy stated that he was not aware of this group at the time, noting that his office created the Public Utility Advisory Commission ("PUAC") to which they sent the COS study to evaluate. He recalled believing that this would have been the first time that a group of users would be involved in reviewing the issue. Asked who created and appointed the members of PUAC, Mayor Murphy responded that his office would have handled the actual appointment process and then the City Manager's Office would have assigned a liaison to work with the commission.

Mr. Romano later asked Mayor Murphy whether Council had to approve loans it received from the State. Mayor Murphy stated that it probably did as a routine matter. Mr. Romano asked Mayor Murphy whether he could recall any discussions after the January 29, 2002 Closed-Session meeting about the implications of the State Revolving Fund ("SRF") loans the City was receiving, particularly in terms of the City's potential non-compliance with some of the loan conditions. Mayor Murphy could not recall any specific discussions, only that he understood that the City was continuing to receive loans from the State. Mayor Murphy clarified that November 2002 would be the more appropriate date (as opposed to January 2002) in terms of charging Council with notice of the potential compliance issue. Asked whether the approval of loans would have been put on the docket by the City Manager, Mayor Murphy responded that this would have been the City Manager's duty, noting that the City Manager would have been aware of the potential non-compliance issue as well.

Mr. Romano showed Mayor Murphy a December 8, 2003 e-mail from Salt to Keri Katz (Deputy City Attorney) and Girard regarding the SWRCB's letter to the City requiring sewer rate structure compliance with the loan conditions (Exhibit 22). Mr. Romano directed Mayor Murphy's attention to the paragraph beginning, "The Cost of Service Study (CSS) has been presented in form to the PUAC. . ." and asked him to read it. Mayor Murphy read the paragraph out loud. Pointing to the language that states, "Dennis [Kahlie] has informed me that John Kern has indicated that he doesn't want this to go to Council until after the primary," Mr. Romano asked Mayor Murphy whether he could recall Kern having concerns about the timing of the COS study and the primary elections. Mayor Murphy explained that he did not know why they would have cared about the timing of the COS study at that time, as all they had previously cared about in 2002 was the timing of the water rate increase. Mr. Romano posited that they may have been concerned about the political impact of the change. Mayor Murphy acknowledged Mr. Romano's argument and conceded that the change in rate structure would have been controversial (and was even when it was ultimately approved in June 2004). Mayor Murphy explained, however, that the business community was predominantly supporting his opponent in the primary election and his opponents may have overall been closer to business interests. Mayor Murphy could not recall discussing this political issue with Kern, but noted that it was possible that he did.

Mr. Romano asked Mayor Murphy whether he recalled becoming aware of the SWRCB's letter at this time. Mayor Murphy responded that he could not recall, noting that he understood all along that the State would have to "sign off" on the City's rate structure, so it did

not occur to him that the City could conceal non-compliance in the first place. Mayor Murphy explained that, at some point, he was told that the City had received two letters from the SWRCB demanding compliance by June 30, 2004. He stated that the letter referenced in the Salt e-mail was likely the first letter, which Mr. Romano acknowledged as correct, and that he did not learn about its existence until after the second letter was received.

Mr. Dahlberg inquired about Mayor Murphy's view of government regulations, in particular whether he had a general understanding of what the ultimate effect of non-compliance with the rate structure would be when the November 2002 Salt and Vattimo memorandum was circulated. Mayor Murphy explained that he believed the City had to comply because the State required it, but he did not believe that their loans would actually be called back. Mayor Murphy noted that he knew people on the SWRCB and did not actually believe the funds would be pulled without real notice. Mayor Murphy clarified that he was not downplaying the SWRCB's authority; rather, he was expressing the pragmatic view that SWRCB staff were sensible people and he would have expected that they would have been willing to work with the City to reach a resolution. Mayor Murphy later noted that he had a friend on the SWRCB Board and, though he did not discuss the compliance issue with him, believed that he could use this contact if it became necessary to obtain a thirty-day extension on the compliance date. Asked whether he believed that other Council members had a similar perception of the State's demands, Mayor Murphy did not answer the question, instead noting that the State was ultimately on the City's side when it came to working toward water purity and cutting down on sewage spills. He believed that they would not be an adversary on the sewer rate structure compliance issue.

Mayor Murphy explained that once it became clear that the State had given the City a mandate to comply with the approved sewer rate structure, there was no more maneuvering on the issue. Mayor Murphy recalled the hearing on this issue in 2004 and remembered that there was some opposition still. Mr. Romano pointed out that Kelco had written the Mayor a letter informing him of their contributions to his campaigns. Mayor Murphy acknowledged his understanding at the time that Kelco had contributed to his campaign, but that this did not affect his decisions, particularly in 2004 when there was no way around coming into compliance.

Mr. Romano asked Mayor Murphy whether a final offering statement was created for the Sewer POS that we believe was approved in September 2003 but was then pulled. Mayor Murphy could not recall the specifics, but just understood that the bonds were not issued. He could not recall whether these bonds got to the point of being reviewed.

Remediation

Mr. Romano asked Mayor Murphy whether he had any suggestions as to the City's structure or processes to avoid similar financial crises in the future. Mayor Murphy explained that he believed that the Disclosure Practices Working Group -- which the City created upon the advice in V&E's first investigative report -- was a good idea. He believed that City staff tended to be quite disjointed in terms of process, so it would be beneficial to have a central group to coordinate all the different approaches to disclosure-related issues. He was not certain how well this particular recommendation was working, but was aware that it had been implemented.

Mayor Murphy also emphasized that if Council were to be held responsible for the approval of disclosure statements and financial statements, there would have to be an intensive training process to prepare the Council members for this responsibility. He believed there should be a two-day training seminar on securities law and the responsibilities of elected officials. This training should not just be at the beginning of an elected officials term in office but rather should continue and be updated on a yearly basis. He suggested that an audit committee may be needed to oversee this training regimen.

WF&G